FASB FINANCIAL ACCOUNTING STANDARDS BOARD

# Board Meeting Handout

# Codification Improvements: Financial Instruments—Credit Losses (Topic 326): Targeted Improvements to the Accounting for Troubled Debt Restructurings (TDR) for Creditors

**March 16, 2022**

## Meeting Purpose

1. The purpose of this decision-making meeting is to redeliberate the determination of the effective interest rate (EIR) for entities that use a discounted cash flow (DCF) model to measure the current expected credit losses (CECL) allowance for assets that are modified and accounted for as a continuation of the original asset.

| Question for the Board |
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| 1. Does the Board want to require that an entity use an EIR derived from the post-modification contractual interest rate for entities using a DCF approach to measure the allowance for credit losses for financial assets that are modified and accounted for as a continuation of the original financial asset? |

## Issue Background

2. At the February 2, 2022 Board meeting, the Board decided that an entity using a DCF method is not required to estimate the allowance for credit losses for modifications of receivables made to borrowers experiencing financial difficulty and that the post-modification contractual interest rate *may* be used when determining the financial asset's EIR by entities that continue to measure the allowance for credit losses using a DCF method.

3. Since that Board meeting, stakeholders have asked whether it was the Board's intent to provide an election regarding the EIR to be used if an entity continues to measure the allowance for credit losses on its financial assets using a DCF method for modified financial assets that would be accounted for as a continuation of the existing asset after applying the modification guidance in paragraphs 310-20-35-9 through 35-11. Those stakeholders questioned whether an entity *must* use a post-modification EIR. If so, then the effect of an interest rate concession or term extension would not be captured incrementally in the allowance for credit losses.

## Staff Observation and Recommendation

4. The staff recommends requiring that an entity use a post-modification derived EIR in determining the allowance for credit losses under a DCF method if the modification is accounted for as a continuation of the existing asset. The staff recommends this alternative because the staff believes that it is most closely aligned with the Board’s intent to eliminate troubled debt restructuring (TDR) recognition and measurement and it aligns with the current accounting practice for non-TDR asset modifications that are accounted for as a continuation of the existing asset.

FINANCIAL ACCOUNTING STANDARDS BOARD

**Board Meeting Handout**

**Reference Rate Reform**

**March 16, 2022**

## Meeting Purpose

1. The purpose of this Board meeting is to discuss a potential change to the scope of the Reference Rate Reform—Deferral of the Sunset Date of Topic 848 project to include an additional issue pertaining to the definition of the Master Glossary term *Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate* (SOFR Swap Rate).

| **Questions for the Board** |
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| 1. Does the Board want to modify the scope of the Reference Rate Reform—Deferral of the Sunset Date of Topic 848 project on the technical agenda to include amendments to the definition of the SOFR Swap Rate?<br><br>2. Does the Board want to amend the definition of the SOFR Swap Rate so that any swap rate based on SOFR meets the definition and, therefore, qualifies as a benchmark interest rate for purposes of applying fair value hedge accounting?<br><br>**Transition, Effective Date, and Comment Period Length**<br>3. Does the Board want to change any decisions on transition, effective date, or the length of the comment period as a consequence of amending the definition of the SOFR Swap Rate? |

## Issue

2. The SOFR Swap Rate was introduced as a Master Glossary term in Accounting Standards Update No. 2018-16, *Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes.* The current definition is limited to the OIS rate based on SOFR.

3. In the deliberations that led to the issuance of Update 2018-16, the Board solicited feedback on whether to permit a more generic definition of the swap rate based on SOFR that would be comparable with the definition of the LIBOR swap rate and would permit any swap rate

based on SOFR, either the OIS rate based on SOFR or forward-looking term rates based on SOFR (SOFR term), to qualify as benchmark interest rates. The basis for the Board limiting the definition included within Update 2018-16 is as follows:

> BC18. In redeliberations, the Board decided to confirm its decision to add only the OIS rate based on SOFR as a benchmark rate in GAAP for hedge accounting purposes. The Board concluded that a swap rate based on a SOFR term rate does not at present meet the characteristics of a benchmark interest rate for several reasons. First, unlike a SOFR OIS swap that has a floating leg referencing the overnight SOFR rate based on actual overnight repo transactions, a SOFR swap that has a floating leg referencing a SOFR term rate would not be based on actual term repo transactions. Second, neither derivative nor cash instruments referencing a SOFR term rate exist. And, third, the Board observes the uncertainty about development of a swap rate based on a SOFR term rate given the FSB's recent statement that indicated that more limited use of term rates would be compatible with financial stability. Therefore, the Board concluded that it would be premature to include the rate as a benchmark rate as part of the amendments in this Update. **The Board plans to monitor the development of SOFR term rates in the marketplace and is prepared to consider a SOFR term rate when that rate emerges in the marketplace.** The Board notes that the LIBOR swap rate continues to be an eligible benchmark rate. [Emphasis added]

4. The staff has been monitoring the development of a SOFR term rate in response to the Board's statement in paragraph BC18 above. Recently, the Alternative Reference Rates Committee (ARRC) issued a formal recommendation of a SOFR term rate.

## Transition, Effective Date, and Comment Period Length

5. At the December 15, 2021 Board meeting, the Board decided that the proposed amendments would be effective immediately upon the issuance of a final Update and applied prospectively. The Board decided on a comment period of 45 days.